



United States Department of the Interior

MINERALS MANAGEMENT SERVICE

Washington, DC 20240

OMB Control Number 1010-0126

Expiration Date: February 28, 2003

FEB 29 2000

Dear Operator:

The Minerals Management Service (MMS) has selected one or more Gulf of Mexico lease(s) that you operate to be included in the second phase of a pilot project (Pilot) in which we will take natural gas royalties in kind beginning April 1, 2000. For the term of the Pilot, natural gas royalties will be taken in kind from offshore leases as defined in the Outer Continental Shelf Lands Act of 1953 (OCSLA, 43 U.S.C. 1337(g)). The purpose of the Pilot is to examine the methods and feasibility of taking natural gas royalties in kind.

This letter provides the procedures and establishes the terms and conditions under which the United States (Lessor) will take royalty gas in kind during this project. Our authority is the Outer Continental Shelf Lands Act at 43 U.S.C. 1353 and the royalty provisions contained in your Federal lease(s). For the purposes of this letter, royalty gas means the daily Federal lease production multiplied by the lease royalty rate.

Term

The Lessor will take all royalty gas from the properties listed in the enclosure beginning on the 1st day of April 2000 and ending on the last day of the month subsequently designated by the Lessor as the date of termination. The Lessor will provide Lessee and Operator with a minimum 30-day prior written notice of termination of in-kind status and will provide a 45-day notice of termination, if possible.

Royalty-in-Kind Applicability

You must deliver all royalty gas to the Lessor from the selected leases, including royalty gas from newly producing wells on these leases or newly producing leases added to commingling agreements. Royalty gas must be placed in marketable condition at no cost to the Lessor, even if the activities required to meet this condition are performed downstream of the point where royalty gas is delivered to Lessor. Marketable condition means the condition generally acceptable to purchasers in the field or area. Questions regarding marketable condition should be directed to the Lessor's Program Coordinator (under "Lessor Point of Contact" at the end of this letter).

The amount of any flash gas allocable to the lease obtained downstream of the Facility Measurement Point (FMP) will be included in the adjustments provided for volumetric makeup in the subsequent month as described under "Balancing Account and Imbalances." Royalty gas delivered to Lessor includes rights to process royalty gas to extract natural gas liquids. For the Bluewater Pipeline System, the royalty gas delivered to Lessor includes rights to entrained pipeline condensate recovered downstream.

Royalty Gas Delivery

The Lessor will take delivery of the royalty gas at the delivery point. The Lessee must deliver or accomplish delivery of royalty gas to the Lessor at the delivery point at the same frequency as it is produced and transported from the property. Only in the case of normal operational imbalances or subsequent month imbalance adjustments (see below under "Balancing Account and Imbalances") shall the Lessee deliver more or less than the royalty share to the Lessor. Unless otherwise agreed, delivery will be assumed to be daily.

The delivery point for royalty gas produced from the selected leases is the FMP that is approved by MMS as the royalty settlement point. The delivery point FMP is identified in the enclosure. If your records show that there is more than one approved FMP, after you consult with us, we will designate in writing one or more FMP(s) as the delivery point(s). The Lessor shall have custody, possession, and responsibility for royalty gas beyond the delivery point.

We are not requiring you to process the royalty gas.

Fulfillment of Royalty Obligations

Delivery of the accurate volume of royalty gas (taking into account the effects of normal operational imbalances) in accordance with the terms of this letter will satisfy in full the Lessee's royalty obligation to the Lessor. However, the rights, duties, and obligations that currently exist between the Lessor, Lessee, and Operator for natural gas avoidably lost prior to the FMP or gas used on or for the benefit of the lease under 30 CFR part 202 remain in effect.

All rent or minimum royalty obligations on any property in this program remain the responsibility of the Lessee. If MMS believes the Lessee owes minimum royalties, we will issue an appropriate order to pay. The Lessee will have 30 days to review the bill and make payment or to appeal the bill.

Lessor Obligation to Take

The Lessor agrees to take 100 percent of the royalty gas delivered daily for the account of the Lessor or its designee at the delivery point. The Lessor, using customary industry practices set forth in GISB standards and the Council of Petroleum Accountants Societies (COPAS) White Paper on Producer and Operator Roles and Responsibilities for nominating and scheduling transportation services, will exercise its best efforts to minimize the occurrence of imbalances

with you and other lessees. Where possible, you will use a predetermined allocation equal to the royalty rate.

Communication with Lessor

No later than 10 calendar days before the first day of each month, you must notify the Lessor of the daily royalty gas volumes anticipated for the following month of production. You may make other arrangements for timely notification only if acceptable to the Lessor. The Lessor understands that any such estimate is not a warranty of actual deliveries to be made but is provided to facilitate planning.

You must also use reasonable efforts, consistent with industry practice, to inform the Lessor regarding significant changes in gas production levels and/or royalty shares anticipated for project properties. Such communication must occur as soon as practicable after you know of such anticipated changes in production levels.

Responsibilities for Penalties

To facilitate timely and accurate custody transfer of royalty gas, you will communicate with Lessor using customary industry practices regarding volumes of royalty gas to be nominated for movement beyond the delivery point(s). The Lessee will incur all transportation-related penalties incurred beyond the delivery point resulting from any failure of the Lessee to make royalty gas volumes available to Lessor consistent with your communication regarding volumes to be delivered. This does not apply to normal production variances or to emergency operational situations where penalties result despite your reasonable efforts in communicating to Lessor.

The Lessee will incur no transportation or royalty-related penalties because of the Lessor's failure to nominate or take delivery of gas volumes consistent with your communications.

Balancing Account and Imbalances (Lease Level Imbalances)

Requirements for handling imbalances are outlined below:

- Imbalances will be determined on the basis of difference between the royalty share of production and the actual volumes delivered. These imbalances will be maintained at a lease, agreement, or FMP level. All royalty gas, including flash gas, will be balanced at the same level.
- You, as the Operator, must provide the lease imbalance statement to the MMS point of contact noted below no later than 45 days after the end of the month of production, unless MMS approves an alternative timeframe for submission of the statement. Your imbalance statement must specify whether quantities are reported in Mcf or MMBtu, and must indicate the pressure base used in measurements.

- Deliveries for the month following the month when the imbalance statement is due will be adjusted to provide for volumetric makeup of the monthly imbalances. The volume adjustment will be made in equal amounts each day of the month, prorated to resolve the identified imbalance. In extraordinary imbalance situations, you will work together with Lessor to reach mutually acceptable methods of imbalance resolution.
- Ordinary imbalances remaining upon cessation of the royalty-in-kind term or cessation of production will be settled on the basis of the applicable first-of-month indices for the final month of in-kind delivery published in *Inside FERC*. The applicable indices are:
 - Leases on Transco's North High Island System: Transco Zone 2 Index
 - Leases on HIOS: ANR LA Index
 - Leases on ANR: ANR LA Index
 - Leases on UTOS: Average of ANR LA and NGPL LA Indices
 - Leases on Bluewater Pipeline: Average of Columbia Gulf and Tennessee LA Indices
 - Other Leases: Contact Lessor Program Coordinator
- The applicable index price, net of transportation costs from the lease for the final month of delivery, will be used to value the final imbalance. The applicable over- or undertaken Lessees will report the imbalance volume and value on the Report of Royalty Sales and Remittance (Form MMS-2014) as either a positive or negative for the final month of delivery. Interest will accrue from 60 days after the final month of delivery.

Volume Reconciliations

The MMS analysts will monitor and reconcile production and volumes delivered with additional data, including pipeline data. MMS will attempt to reconcile volumes as soon as practicable. Reconciliations will involve communication between you and the Lessor. Upon project termination, you, as the Operator, must issue a final gas imbalance statement. You will settle in accordance with the section "Balancing Account and Imbalances."

Reporting

You must continue to report natural gas production to MMS on the Oil and Gas Operations Report (OGOR) or Monthly Report of Operations (Form MMS-3160), as applicable, under current requirements and frequencies as specified in MMS regulations and the *MMS PAAS Reporter Handbook*. You will not be required to report natural gas information for the leases in this program on the Form MMS-2014 or other similar form for the term during which the Lessor takes royalty in kind, except under provisions described below in this section and under provisions described under "Balancing Account and Imbalances." Reporting and payment requirements for production and royalties for any crude oil or condensate for the leases included in this natural gas royalty-in-kind program will not change. Reporting will not change for leases not included in this program.

You must report any transportation allowances and any final imbalances on your Form MMS-2014. You will report separate entries for the allocated volume and values of transportation costs and final imbalances for each of the lease(s) identified in the enclosure. The payor code you will use for this Form MMS-2014 is your existing applicable code.

Lessor's Designee

At times, the Lessor may act by or through a duly authorized designee. In such event, the Lessor will provide you with prior written notification of the identity of its designee(s) including the person to contact. Such notification will include specific duties that will be handled by the designee on behalf of the Lessor. The Lessor also will provide written notification to you when the designee is no longer authorized to act on Lessor's behalf for the purposes of this letter. You are authorized to communicate with the designee as specified in the notification. You will not be required to direct communications to both the Lessor and its designee. For purposes of this letter, if the Lessor notifies you that it will use a designee during the Pilot, references to Lessor shall refer to the Lessor's designee.

The Lessor requires the designee to agree in writing that, when acting on behalf of Lessor, the designee must comply with all provisions of this letter that are applicable to the Lessor.

Audit Rights

The Lessor may audit your records regarding all information relevant to volumes and qualities of royalty gas produced, stored, used on the lease, measured, delivered, and, if applicable, transported. The MMS reserves the right to examine the financial records of you and the Lessees of the subject properties related to any transportation expenditures incurred prior to the delivery point.

Lessees, Operators, and revenue payors must maintain all records of transactions mentioned in the above paragraph for a period of 7 years from the day on which the relevant transaction occurred unless MMS notifies the record holder of an audit or investigation. When an audit or investigation is underway, records must be maintained until the record holder is released in writing from the obligation to maintain the records.

Lessor Point of Contact

Copies of all correspondence between Operator and Lessor should be kept on file by the Operator. Points of contact for the Lessor are as follows:

Lessor Program Coordinator:
Mr. Gregory W. Smith
Telephone: 303-275-7102; FAX: 303-275-7124
Email: gregory.w.smith@mms.gov

Imbalance Statements:

Mr. Martin Grieshaber

Telephone: 303-275-7118; FAX: 303-275-7124

Email: martin.grieshaber@mms.gov

Scheduling, Transportation, and Imbalance Issues:

(MMS contractor assumes all responsibilities of the Lessor for these issues. See enclosure for MMS contractor point of contact.)

Reporting Issues:

Mr. Andy Sandoval

Telephone: 303-231-3777; FAX: 303-231-3189

Email: alfonso.sandoval@mms.gov

Electronic Funds Transfer:

Ms. Kathy Jarrett

Telephone: 303-231-3669; FAX: 303-231-3501

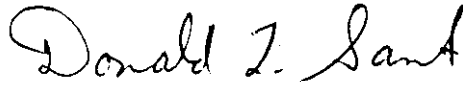
Email: kathleen.jarrett@mms.gov

The Lessor acknowledges that you have given proper notice when you communicate with the Lessor using the telephone number, fax number, or email address given above, provided any telephone communication regarding volumes is confirmed by fax or email no later than 1 business day after telephone communication occurs. The Lessor further agrees to make arrangements to receive such communications regarding gas scheduling issues on a 7-day-a-week, 24-hour-a-day basis. Operators and Lessees should communicate with the above points of contact to answer any further questions.

The Paperwork Reduction Act of 1995 requires us to inform you that the information being collected as a result of this letter is necessary to document fulfillment of royalty obligations on minerals removed from leases on Federal lands. We will use this information to maintain and audit lease accounts, and we estimate the burden for reporting electronically is 1 hour per property per month. Comments on the accuracy of this burden or suggestions on reducing this burden should be directed to the Information Collection Clearance Officer, MS 4230, MMS, 1849 C Street, NW., Washington, DC 20240. Proprietary information submitted to the U.S. Department of the Interior is protected in accordance with standards established by the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1733), the Freedom of Information Act (5 U.S.C. 552(b)(4)) and the Departmental Regulations (43 CFR 2). Storage of such information and access to it are controlled by strict security measures. An agency may not

conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB number.

Sincerely,

A handwritten signature in black ink that reads "Donald Z. Sant". The signature is fluid and cursive, with the first name "Donald" being the most prominent part.

for

Lucy Querques Denett
Associate Director for
Royalty Management

Enclosure